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C O N F I D E N T I A L CARACAS 002740

SIPDIS

NSC FOR TSHANNON AND CBARTON
ENERGY FOR DPUMPHREY AND ALOCKWOOD

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SUBJECT: EXXONMOBIL: STAYING THE COURSE IN VENEZUELA

REF: CARACAS 2570

Classified By: Economic Counselor Richard Sanders; for reasons 1.4 (b) and (d)

SUMMARY

¶1. (C) With the August 12 signing of the Preliminary Development Agreement (PDA) for a giant petrochemical project, ExxonMobil finally looks to have overcome the disappointment of being shut out of the Mariscal Sucre natural gas project in 2002. Econoff met July 22 with ExxonMobil de Venezuela President Mark Ward to review the status of company projects. Cerro Negro, the company's flagship extra heavy crude project, is operating well and Ward hopes shortly to receive approval to move ahead with debottlenecking the project upgrader. ExxonMobil will begin a long-term production test in September on wells in the La Ceiba field while it has also submitted a joint development proposal to PDVSA outlining how the field could be developed in concert with PDVSA's Ceuta-Tomoporo field. Ward emphasized that ExxonMobil is interested in Venezuela over the long term, and particularly in big projects that would play to ExxonMobil's strengths. End Summary.

¶2. (SBU) On August 12, ExxonMobil de Venezuela President Mark Ward signed the PDA for a $3 billion petrochemical project that has been under discussion with the GOV for nine years. In a July 22 meeting, Ward anticipated that the Preliminary Development Agreement (PDA) would soon be signed. He added that a meeting might be arranged between President Chavez and ExxonMobil Chairman Lee Raymond in early October to discuss further that project. Ward also briefed econoff on the status of other ExxonMobil projects in Venezuela which range from the 25 percent share the company has in the 16,000 b/d Quiamare-La Ceiba field (operated by Repsol) to the multi-billion dollar Cerro Negro project.

CERRO NEGRO

¶3. (SBU) Ward reported that ExxonMobil is pleased with the operation of its flagship Venezuelan project, Cerro Negro, which currently upgrades 120,000 b/d of extra heavy crude into 110,000 b/d of syncrude. (Note: Cerro Negro is one of the four so-called "Strategic Associations" in which various international oil companies partner with PDVSA to exploit the extra heavy crude of Venezuela's Orinoco heavy oil belt.) Ward is hopeful ExxonMobil will receive approval "within weeks" from the GOV to proceed with debottlenecking the project upgrader to increase its capacity by 20 percent to some 145,000 b/d of extra heavy crude.

¶4. (C) While Ward underlined that the existing Cerro Negro contract covers debottlenecking and that he nominally only needs construction permits from the Ministry, he acknowledged an on-going discussion with the GOV about royalty payments on any additional barrels resulting from the debottlenecking. (NOTE: The royalty for the Cerro Negro project - as with all the Strategic Associations - is currently one percent. This was agreed by the GOV (pre-Chavez) as an incentive for development of these multi-billion dollar projects. The royalty holiday lasts for nine years or until the project has re-couped three times its investment level, whichever comes first.) Ward said the GOV is pressing for a 20 percent royalty rate for the additional barrels (the 2001 Hydrocarbons Law allows a 20 percent royalty for extra heavy crude vice 30 percent for other grades). He said ExxonMobil would not agree because of the precedent it might set for the eventual royalty for the project's base production which ExxonMobil believes should revert to the 16.67 percent royalty in place at the time the original contract was signed.

¶5. (C) Turning to the issue of field operation, Ward said associated gas production has built up faster than had been anticipated. This has, he said, affected all the Orinoco heavy oil belt projects and now necessitates that Cerro Negro undertake additional investment in separation and compression equipment and a pipeline. Cerro Negro is currently

delivering 20 million cubic feet per day (mcfd) to gas to PDVSA but Ward anticipated that this would increase to 100 mcfd within two years. He added that ExxonMobil is currently recovering its costs from the gas sales, which is "the most that can be expected with a monopoly buyer."

¶6. (C) Ward anticipates that both the gas handling and debottlenecking projects will cost $150 million apiece. He hopes to start the gas project at the end of 2004 and the debottlenecking in early 2005. If so, the new production would come on-line in the first quarter of 2006. Ward also informed econoff there will be a 30-day shutdown for maintenance of the Cerro Negro upgrader in mid-2005. Field production will also be shut-in for 12 days; the other 18 days of production will be sold to PDVSA as heavy oil.

¶7. (C) Finally, Ward acknowledged that ExxonMobil has begun consideration of a Cerro Negro II which could be supported by the existing concession area. The question, he said, is what level of upgrading would be demanded by the GOV and whether it would be commercially viable. (Note: Cerro Negro produces a 16 degree API syncrude, the lowest of the four projects.) Although ExxonMobil has agreed to study the possibility of applying enhanced oil recovery techniques, Ward said bluntly that it makes little sense for Venezuela - with 300 million barrels of recoverable reserves of extra heavy crude) "to spend even one dollar more than it needs to increase recovery rates." (Comment: Ward's skepticism about the economics of increasing the oil recovery rate for a second phase of the Cerro Negro project is directly opposed to the current energy policy of the GOV which is pressing for an increase in the current 7-10 percent recovery rates of the extra heavy crude projects.)

LA CEIBA

¶8. (C) In September, ExxonMobil will begin a long-term production test on wells in the La Ceiba field south of Lake Maracaibo. The La Ceiba project is a risk/profit sharing agreement inked in 1996 by Mobil. Ward estimates that it is a 180 million barrel field ("not a company maker.") ExxonMobil has drilled five wells in La Ceiba and will test two that are currently producing a total of 10,000 b/d. The oil will be moved by pipeline to a PDVSA facility in Barua. While Ward was hopeful that the test would generate sufficient data to allow the company to decide whether to move ahead with field development, he was clearly skeptical. If not, ExxonMobil would be required to drill at least one additional well and continue testing in order to satisfy its exploration requirement. Ward said he is concerned about water in the reservoir. Ward also told econoff that ExxonMobil has provided PDVSA with a joint development proposal outlining how La Ceiba could be developed with PDVSA's nearby Ceuta-Tomoporo field.

OTHER BUSINESS

¶9. (C) In a quick overview of other possible business opportunities, Ward noted that ExxonMobil would still be interested in participating in the development of Blocks 2, 3 or 4 of the Deltana Platform offshore natural gas project. ExxonMobil plans to buy the data packages for whatever blocks the GOV bids in the Gulf of Venezuela and off Falcon state. Ward said this would be a natural extension of ExxonMobil's "play" in Colombia.

¶10. (C) With respect to downstream business, Ward said the company is holding its own in the lubricants business. In terms of the local gasoline market, however, he acknowledged that ExxonMobil is incurring significant losses because of the controlled prices. Ward said bluntly that ExxonMobil will not be willing to ride out a losing business forever and that the Venezuelan fuels market is simply not sustainable for foreign companies.

COMMENT

¶12. (C) Ward emphasized that ExxonMobil is interested in operating in Venezuela over the long term, and particularly in big projects that play to the company's strengths. With the successful August 12 signing of the Preliminary Development Agreement (PDA) for its planned multi-billion dollar petrochemical project (reftel), ExxonMobil finally looks to have found such a project in Venezuela and overcome the disappointment of being shut out of the Mariscal Sucre natural gas project in 2002. Like its rivals such as ChevronTexaco and Shell, ExxonMobil has not been deterred by the ongoing political noise from considering large

investments in Venezuela. Unlike its rivals and true to its corporate philosophy, however, ExxonMobil has taken a lower profile and more measured pace.
McFarland

NNNN